
From: Karen Thomas [mailto:Karen.Thomas@icba.org]
Sent: Monday, June 05, 2006 11:08 AM
To: ChangeInControl
Cc: Gruenberg, Martin J.; Carter, John F.
Subject: ICBA Comment on Home Depot Inc Change in Control Notice

Please find attached a comment letter from the Independent Community Bankers of America on The Home Depot, Inc. Notice of Change in Control regarding EnerBank USA. Please call the undersigned if you have any questions regarding our comments. thank you

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ICBA: The Nation's Voice for Community Banks



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June 5, 2006

Mr. John F. Carter
Regional Director
FDIC - San Francisco Regional Office
25 Jessie Street at Ecker Square, Suite 2300
San Francisco, California 94105

Re: Initial Comments and Request for Public Hearings Regarding FDIC
Change in Bank Control Notice Filed By The Home Depot, Inc., In
Connection With Its Intent To Acquire EnerBank USA.

Dear Mr. Carter:

The Independent Community Bankers of America¹ (ICBA) submits this letter in opposition to the proposed acquisition by The Home Depot, Inc. (Home Depot) of EnerBank USA (EnerBank), an industrial loan corporation headquartered in Salt Lake City, Utah. In addition, because of the widespread interest in this change in control notice and the serious public policy issues involved, ICBA urges the FDIC to extend the formal comment period and hold public hearings so that a broad cross section of the public's views can be heard.

Although many aspects of Home Depot's business plan are unclear because of the limited information available in the public section of the application, the general design of the plan runs counter to long-established U.S. policies, and we urge the FDIC to reject the application. The application presents many issues similar to those presented by Wal-Mart's deposit insurance application for a Utah industrial bank, as well as issues unique to Home Depot's application and business plan for EnerBank. Our opposition is based on the following principles:

¹ *The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 265,000 Americans, ICBA members hold more than \$876 billion in assets \$692 billion in deposits, and more than \$589 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

1. Permitting Home Depot to acquire an industrial bank would violate long-standing U.S. policy, most recently affirmed in the Gramm-Leach-Bliley Act of 1999, of maintaining the separation of banking and commerce.
2. Permitting Home Depot to acquire an industrial bank could pose severe risks to the Deposit Insurance Fund and to the banking system itself, and raise serious safety and soundness concerns because it would operate outside the consolidated supervisory framework Congress established for owners of insured banks.
3. Permitting Home Depot to acquire an industrial bank would create competitive imbalances in the banking world and have a damaging effect on local financial institutions.
4. Home Depot's business plan for the industrial bank raises conflicts of interest and serious affiliate transaction issues under Section 23A of the Federal Reserve Act² and Federal Reserve Regulation W.
5. Permitting Home Depot to acquire an industrial bank raises serious concerns with respect to the company's governance and executive management.

Violates Separation of Banking and Commerce

Home Depot's change in control notice states that the company's "... proposed business plan represents a prudent approach for The Home Depot to bring a proven banking operation into its family of businesses."³ Adding an FDIC-insured financial institution to a family of commercial businesses is inconsistent with our nation's long tradition and legal standard of keeping banking and commerce separate. This principle was most recently reaffirmed by Congress when it closed the unitary thrift holding company loophole in the Gramm-Leach-Bliley Act of 1999.⁴ Up until that time, unitary thrift institutions could be owned by commercial firms. Congress determined that such alliances were not in the best interests of our nation and closed the "unitary thrift holding company loophole" to prevent future alliances from forming.

Keeping banks and commercial interests separate is based on solid grounds. First, it guards against the excessive concentration of economic power that would be created by the merger of corporate and financial conglomerates. Second, it ensures the impartial allocation of credit, protecting our economy from conflicts of interest that might arise under the common ownership of a bank and commercial firm. And third, it safeguards

² 12 U.S.C. 371c.

³ The Home Depot, Inc. Interagency Notice of Change in Control - Public, May 8, 2006, page 11 ("Change in Control Notice").

⁴ Gramm-Leach-Bliley Act (PL 106-102), Sec. 401.

against the improper extension of the Federal safety net, which could put taxpayer dollars at risk if an FDIC-insured bank is weakened by a troubled corporate affiliate.

In closing the unitary thrift holding company loophole--one of the last remaining loopholes allowing the mixing of banking and commerce⁵-- Congress was keenly aware that the integration of financial and commercial firms had been a historical failure. Many experts believe the *kieretzu* system in Japan contributed directly to that nation's long, spiraling recession. Japan has still not fully recovered from this 15-year malaise. Comparable arrangements in South America and the Asean⁶ nations produced similar negative results.

Recently, Congress once again expressed concern over this issue because of Wal-Mart's application to charter an ILC through a loophole in the law. House Financial Services Committee Financial Institutions and Consumer Credit Subcommittee Chairman Spencer Bachus (R-AL) has indicated he intends to hold hearings on the ILC issue later this year. And Reps. Paul Gillmor (R-OH) and Barney Frank (D-MA), among others, have called on the FDIC to delay any decisions on applications involving ILCs until Congress has had the opportunity to review and take action on this issue. Given the fundamental and likely irreversible changes posed to the financial system from the rapid exploitation of the ILC loophole in recent years, we believe this is a highly prudent request and strongly urge the FDIC to honor it.

Approving the Home Depot application in combination with applications filed by other big box retailers would set a dangerous precedent. It will trigger a parade of commercial firms seeking to exploit the ILC loophole to obtain a banking affiliate. If the FDIC permits the nation's largest retailers to burrow through this loophole, who could it deny? This would start us down a dangerous and irreversible course that could undermine one of the great strengths of the U.S. financial system.

Arrangement Blurs Commercial and Banking Activities, Customer Confusion

Even though Home Depot provides assurances in its notice that EnerBank loans will not be tied to purchases from its stores, the business plan outlined in the notice blurs the line between its lending and commercial activities. The notice states: "EnerBank has had significant success helping local, small contractors achieve business success. This fits with The Home Depot's desire to expand its relationships with contractors and trade professionals -- especially the local, small contractors that are core to The Home Depot's business."⁷

The notice also states that, "EnerBank services will be introduced to The Home Depot's very large commercial customer base -- which includes potentially hundreds of thousands

⁵ The Competitive Equality Banking Act of 1987 generally made FDIC-insured banks subject to the Bank Holding Company Act, but grandfathered certain credit card banks and ILCs.

⁶ Association of South East Asian Nations.

⁷ Change in Control Notice, page 10.

of home improvement and remodeling contractors that EnerBank can partner with. The Home Depot would also support EnerBank's growth with its current partner sponsors and contractors."⁸

From the information available in the public portion of this notice, it is unclear exactly how the relationship among Home Depot, its contractor customers, home improvement customers, and EnerBank will work. It seems likely that Home Depot will use its contractors to market EnerBank's loan services to home improvement customers employing the contractors' services. This relationship is sure to cause confusion for the loan applicants, and raise questions regarding customer protections under the Truth in Lending Act and other required consumer disclosure laws.

Will the customers know that the loan is not tied to the purchase of products from Home Depot, especially since their first point of contact will be a contractor and not a loan officer from the bank? Will the customer be given the opportunity to shop around for better offers, or even know that they can ask their contractor to purchase materials from home improvement stores other than Home Depot? Will there be other incentives provided to borrowers to become Home Depot customers, or EnerBank customers? Will goods be discounted, but credit rates high, or credit rates low, but the price of Home Depot goods high? Or will discounts accrue to the benefit of the contractor and not the borrower-homeowner? The business plan and structure of the arrangement virtually guarantees that there will be conflicts of interest.

These are serious consumer issues that must be fully examined before allowing this alliance to be consummated.

Excessive Risks to Bank Insurance Fund

Home Depot is the world's largest home improvement specialty retailer and the second largest retailer in the United States, operating more than 2,000 stores across North America and processing more than 1.33 billion customer transactions per year. In 2005, Home Depot had \$81.5 billion in sales, with earnings topping \$5.8 billion. Home Depot's sheer size alone, rather than protecting the bank, would pose a severe risk to the Deposit Insurance Fund. It is incorrect to assume that large size equates to safety. As recent history has shown us, with the sudden demise of Enron and WorldCom, the bigger they are, the harder they fall. The airline industry also is filled with examples of very large companies taking very painful falls.

No company, no matter how large, is immune from market disruptions, political turmoil, internal irregularities or legal problems that could cause a sudden drop in business. The losses that the FDIC would endure if EnerBank or its Home Depot parent failed would be staggering. It would jeopardize not only the Fund, but also the fabric of our entire financial system. No financial institution would be immune from the effects of such a failure. Such a risk is simply unacceptable and must be avoided.

⁸ Change in Control Notice, page 10.

Moreover, the specialized nature of Home Depot and EnerBank exacerbates this risk. Home Depot specializes in home improvement products making it particularly susceptible to fluctuations in the general economy, real estate sales, and specifically the home improvement market. While the company is profitable now, there is no guarantee that this success will be protracted. Because Home Depot is susceptible to sudden changes in economic conditions, it may not always be a reliable source of strength for EnerBank.

Similarly, EnerBank shares Home Depot's focus on the home improvement market. The application states that "EnerBank USA's only business is funding fixed-rate, unsecured, close-end, direct consumer installments loans for a broad range of home improvement projects. . . ."⁹ (emphasis added). The application also states that Home Depot will not change that focus and EnerBank will not solicit business directly from consumers, will not provide retail financing or credit cards for consumer purchases, and will not have branches or local offices or meet with customers face to face. Thus, EnerBank will be relying on the strength of a specialized market niche to remain viable.

Sudden changes in the home improvement market could send both Home Depot and EnerBank spiraling into a meltdown. EnerBank's lending portfolio will not be diversified enough to protect against such market volatility. This poses a severe and unacceptable risk to the Deposit Insurance Fund.

These risks assume even greater significance when viewed in the context of the regulatory environment in which a bank owned by Home Depot would operate. As the owner of an industrial bank, Home Depot would not be governed by the Bank Holding Company Act, which imposes ownership and transaction limitations and provides for consolidated supervision at the ownership level. Thus, Home Depot would not be regulated by the Federal Reserve Board, as are other companies that own FDIC-insured banks. This lack of adequate regulation at the ownership level exposes the industrial bank to risks not normally associated with banks. Without proper regulatory scrutiny, an industrial bank owner may have financial arrangements that put the solvency of the bank and parent at risk.

It is true that industrial banks are regulated by the FDIC. But as was pointed out in a recent GAO report,¹⁰ the FDIC does not have the same powers to oversee and regulate the entirety of a holding company's operations as does the Federal Reserve. GAO found that even though FDIC examines and supervises insured ILCs, "it has less extensive authority to supervise ILC holding companies than the consolidated supervisors of bank and thrift holding companies [i.e., the Federal Reserve and the OTS]." The report continued, "these ILCs may pose more risk of loss to a bank insurance fund than other insured depository institutions operating in a holding company."

⁹ Change in Control Notice, page 8.

¹⁰ Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority, GAO-05-621, September 15, 2005.

The Bank Holding Company Act gives the Federal Reserve the authority to examine the bank holding company itself and any of its non-bank subsidiaries at any time, while the FDIC has only limited examination authority, and it is generally unable to examine affiliates of banks.

The Federal Reserve also has the authority to establish consolidated capital requirements to ensure that owners are a source of financial strength for the subsidiary bank. Corporate parents of industrial banks are not subject to these capital requirements.

In addition, the Federal Reserve has broad enforcement authority and can issue cease and desist orders, impose civil penalties, and order a holding company to divest non-bank subsidiaries if it determines that ownership of the subsidiary poses a risk to the affiliated bank. The Federal Reserve is the only federal agency authorized to take such actions against bank holding companies.

These broader regulatory safeguards applied to the bank and the bank parent company are critical to ensure safe and sound operations of a financial entity. Without these safeguards to oversee Home Depot and protect EnerBank, the Deposit Insurance Fund, and taxpayer dollars, may be at risk.

Former Federal Reserve Chairman Alan Greenspan was so concerned about commercial firms exploiting the ILC loophole that in his last official communication to Congress as Chairman, Greenspan endorsed legislation for Congress to close the ILC loophole. Greenspan stated:

“The character, powers and ownership of ILCs have changed materially since Congress first enacted the ILC exemption. These changes are undermining the prudential framework that Congress has carefully crafted and developed for the corporate owners of other full-service banks. Importantly, these changes also threaten to remove Congress’ ability to determine the direction of our nation’s financial system with regard to the mixing of banking and commerce and the appropriate framework of prudential supervision. These are crucial decisions . . . they should not be made through the expansion and exploitation of a loophole that is available to only one type of institution chartered in a handful of states.”

Current Federal Reserve Board Chairman Benjamin Bernanke articulated similar sentiments in expressing support for legislation to close the ILC loophole.

The inherent risks to our financial system arising from excessive levels of financial concentration are mammoth and unacceptable. Consider the consequences if Enron or WorldCom had owned a bank. The U.S. has the best banking regulatory agencies in the world. But even those agencies would find it difficult to contain a bank’s serious financial troubles that leak from the financial difficulties experienced by a corporate parent of significant size and resources.

A bank owned by Home Depot would be of substantial size. According to the company's application, it expects the bank to partner with "hundreds of thousands of home improvement and remodeling contractors"¹¹ Moreover, the company has promised to make "an up-front investment of additional equity," "enter into a Capital Assurance and Liquidity agreement," and "provide EnerBank with an accessible line of credit."¹² With such a large volume of contractors feeding loan applications to the bank, and the support of one of our nation's largest corporations, EnerBank can be expected to grow exponentially to the point where the bank's failure would inflict an unacceptable degree of damage on the nation's overall financial system, and pose an unacceptable risk.

This risk is exacerbated by the fact that Home Depot would not be subject to the same level of regulatory scrutiny as owners of banks as discussed above.

Home Depot's application to acquire an industrial bank should be denied in order to avert this risk.

Competitive Imbalance, Impact on Communities and Consumers

A Home Depot-owned financial institution would create competitive imbalances in the banking industry and inflict lasting damages on community banks and thereby the communities they serve.

There is no evidence that the credit needs of home improvement loan customers are not being met by conventional sources, such as banks, thrifts and credit unions. Indeed, community financial institutions are constantly looking for new opportunities to serve their customers, build their communities, and strengthen their loan portfolios, and most have ample available lendable funds to do so.

Neither is there any evidence that Home Depot needs an additional credit outlet for its home improvement customers. Indeed, Home Depot states in its notice that it "already finance[s] home improvements with credit cards and home improvement loans marketed directly to consumers."¹³ With Home Depot's profits growing at a rate of 17% annually, these methods are obviously working, raising questions about the need for an additional source of credit for Home Depot's customers. It is unclear in the application whether these direct marketing efforts will cease or continue if Home Depot acquires EnerBank.

At the same time, the impact of non-local ownership of the bank will be felt throughout the community. America is well served by a diversified financial services industry that gains strength in fair and healthy competition. Community banks are at the core of such a system, and community banks bring value to the communities they serve well beyond their assets. Community bankers live in their communities, they provide funding and loans to support local businesses and economic development, and they have a vested

¹¹ Change in Control Notice, page 10.

¹² Change in Control Notice, page 11.

¹³ Change in Control Notice, page 11.

interest in the economic well being of their communities. In other words, they are stakeholders in their communities. Clearly, Home Depot and EnerBank are not in the same category.

Community banks are only as strong as the communities we serve. If our communities are negatively impacted, our deposit base will suffer, our earning assets will decline, and the level of resources available for economic and capital development and community lending will deteriorate.

We are also concerned that a Home-Depot-owned bank would have the size and resources to engage in predatory pricing to capture the local home improvement loan market to the detriment of locally-owned banks. With Home Depot's resources backing EnerBank, it would have the ability to unfairly undercut loan rates offered by local banks, resulting in lost business opportunities and lower earned interest for community banks.

The marketing technique that Home Depot intends to employ with EnerBank could reduce competition and ultimately result in higher costs for consumers. And even though the notice states loan will not be specifically tied to a Home Depot purchase, since the contractor would be introduced to the bank through Home Depot, this no doubt would build a loyalty to Home Depot products, exactly what Home Depot's stated purpose is.

In addition, EnerBank would actually train contractors to close deals, presenting concerns regarding adequate provision of consumer disclosures such as Truth in Lending disclosures, etc. These contractors are neither employees of Home Depot nor the bank, raising concerns about who will ensure consumers receive proper disclosures and other legally required information.

ICBA also is concerned that there is nothing to prevent Home Depot from expanding its business plan for EnerBank down the road, even though Home Depot has described a very limited business plan in the public portion of its notice and stated that it has no plans to offer traditional banking services. With more than 2,000 locations in North America, should Home Depot decide to expand into retail branch banking, it would have a ready made brick and mortar network in place to create one of the largest branch banking operations in the nation. Considering the volatile nature of the home improvement industry, there is no way to predict how Home Depot's business plans would change if there were a sudden downturn in the industry. Were Home Depot to engage in retail banking through such a network of branches, it would pose a serious competitive threat to the community banking industry and to the health of local communities in much the same way that a retail Wal-Mart bank would pose such a threat.

Illegal Affiliate Transactions, Conflicts of Interest

The structure of the Home Depot-EnerBank arrangement with that of its contractor and consumer customers raises significant conflicts of interest and affiliate transaction issues

under Section 23A of the Federal Reserve Act¹⁴ and Federal Reserve Regulation W, which place quantitative limits on transactions between a bank and its affiliates. In fact, as structured the arrangement is predicated on illegal affiliate transactions.

Section 23A prohibits a member bank from engaging in a “covered transaction” with an affiliate if the aggregate amount of the bank’s covered transactions with an affiliate would exceed 10% of the bank’s capital stock and surplus. Even if EnerBank is not a Federal Reserve member bank, Section 23A still applies. The Federal Deposit Insurance Corporation Act applies Section 23A to every nonmember insured bank in the same manner that it applies to a member bank.¹⁵

It is clear that some of the proceeds of EnerBank’s home improvement loans will be used to purchase goods and services from Home Depot, thereby benefiting Home Depot. For instance, Home Depot’s notice states that “EnerBank’s contractor delivery model will deepen our relationship with contractors—and we believe that will help us earn more of their business.” Section 23A and Federal Reserve Regulation W state that a “member bank must treat any of its transactions with any person as a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate.”¹⁶ Therefore, any proceeds of EnerBank’s home improvement loans used to purchase goods at Home Depot must be considered “covered transactions” and therefore subject to the quantitative limits of Section 23A, since the proceeds of those loans will benefit an affiliate--Home Depot.¹⁷

In light of the stated business plan of Home Depot and EnerBank, it is highly likely that these covered transactions will exceed the 10 percent limit allowable under Section 23A and Regulation W. Since these arrangements are illegal, the application should be rejected.

ICBA is also concerned that the relationship of the contractors to Home Depot with regard to EnerBank’s loans heightens the conflicts of interest inherent in the arrangement and increases the potential for undue pressure or disadvantage to the borrower-homeowners. The relationship is even more troubling when the customer is a Home Depot customer, the contractor is referred to the customer by Home Depot, and EnerBank knows at the outset that the loan will be used to pay the contractor and to purchase goods from Home Depot.

¹⁴ 12 U.S.C. Section 371c.

¹⁵ See 12 U.S.C. Section 1828(j).

¹⁶ See 12 U.S.C. 371c(a)(2) and 12 CFR 223.16.

¹⁷ Based on a previous letter ruling issued by the Federal Reserve in 1996 involving American State Bank in Wilson, Arkansas, we believe that the Federal Reserve would consider EnerBank’s home improvement loans to be “covered transactions” under Section 23A.¹⁷ In the American State Bank situation, the bank extended crop production loans to local farmers, including farmers who leased land from an affiliate. Since the affiliate received lease payments from the farmers based on the farmers’ income, the Federal Reserve ruled that the affiliate indirectly benefited from the bank’s crop production loans and therefore the loans were “covered transactions” under Section 23A. See Federal Reserve Board letter issued to Ms. Charla Jackson of American State Bank, August 26, 1996.

Management / Governance Concerns

Home Depot faces corporate governance and executive management concerns. Recent revelations concerning Home Depot's top executives and management practices raise genuine widespread concern about the corporate governance practices of the company and transparency of its financial condition and business prospects. Notably, retail analysts stated that Home Depot's recent decision to stop reporting quarterly same-store sales figures, coinciding with softer than expected sales during the quarter, was "irresponsible," "dishonest," "highly suspect," and "a terrible way to do business" as a public traded company.¹⁸ Same-store sales is a key metric used across retailers to evaluate how a retailer is performing. Home Depot's decision to reduce transparency on the company's performance is a troubling development. Retail analysts claim it will now be harder for them to access information relating to the health of Home Depot's business.

Another troubling development occurred when the Board of Directors did not show up at a May 25, 2006 Home Depot shareholders meeting. Except for CEO and board chairman Bob Nardelli, no other directors attended the Home Depot meeting.irate shareholders expressed concern about Nardelli's excessive pay package (\$245 million over five years) despite lackluster stock price performance and total return to shareholders. It was reported that Chairman Nardelli did not allow shareholders to ask general questions and the meeting was terminated after 30 minutes.¹⁹ Not having board members available to answer shareholder questions again raises concerns about governance and transparency of Home Depot.

Lacking adequate tools to oversee and supervise Home Depot as the parent company of EnerBank, these developments raise serious issues that must be considered by the FDIC in evaluating the company's fitness to own a bank and the risks posed to the Deposit Insurance Fund.

Conclusion: Fails to Meet Criteria

ICBA contends, as stipulated herein, that the Home Depot application meets at least three of the criteria for disapproval of an application for a change in bank control as set forth in 12 USC 1817(j):

"[T]he effect of the proposed acquisition of control in any section of the country may be substantially to lessen competition. . . and the anticompetitive effects of the proposed acquisition of control are not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served,"

¹⁸ "Defiant Home Depot = Worried Investors," CNNMoney.com, May 16, 2006.

¹⁹ "Shareholders to Home Depot Chief: You're Chicken," CNNMoney.com, May 26, 2006.

"[T]he appropriate Federal banking agency determines that the proposed transaction would result in an adverse effect on the Bank Insurance Fund. . . ,"
and

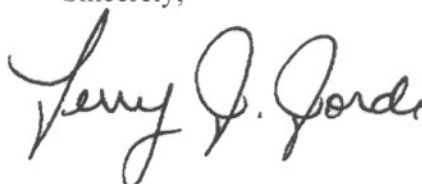
"[T]he competence, experience, or integrity of any acquiring person or of any of the proposed management personnel indicates that it would not be in the interest of the depositors of the bank, or in the interest of the public to permit such person to control the bank."

In addition, this notice also raises serious affiliate transaction issues under Section 23A of the Federal Reserve Act²⁰ and Federal Reserve Regulation W, which place quantitative limits on transactions between a bank and its affiliates. As structured, we believe the arrangement is predicated on illegal affiliate transactions.

Therefore, the application must be denied. There is no clear public policy reason or social benefit to be served by permitting Home Depot to acquire control of EnerBank at this time.

In addition, because of the widespread interest in this matter and the serious public policy issues involved, ICBA urges the FDIC to release the non-public portion of Home Depot's notice, extend the formal comment period for at least 30 days beyond the release date of the additional information, and hold public hearings so that a broad cross section of the public's views can be heard.

Sincerely,



Terry J. Jorde
ICBA Chairman

cc: Honorable Martin J. Gruenberg, Acting Chairman, FDIC

²⁰ 12 U.S.C. Section 371c.